Fat Profits Inspire Credit Card Boom At Top Institutions

Continued from Page 1

are difficult to reach since banks face legal obstacles in opening branches outside their home states.

These institutions hope to sell a wider range of financial products to credit card customers, Mr. Friedman said. "I think it's part of a broader strategic vision," he added.

Other banks, however, have expanded portfolios simply to increase credit card business, which has become increasingly profitable in recent years. "It's a quest for growth because of the profitability of the business," said Donald J. Auriemma, a Garden City, N.Y.-based consultant.

THE CREDIT CARD BOOM
FIRST IN A SERIES

The credit card business has been earning a return on assets of 4% or 5%, considerably higher than other banking products.

Randolph W. Wyckoff, senior vice president at the Bank of Virginia, Richmond, said he expected growth to continue because bad loans already are lodged in portfolios. If loan volume rises, then, as these bad loans mature, loan losses will become a larger percentage of the portfolios, he explained.

"You've got to go to the world, to the United States, or to the state next door," Mr. Wyckoff said. "It's tough to stop growing."

Card Issuing Produces High Profits

Almost 90% of credit card revenues and a large percentage of profits come from the card-issuing side of the business — putting cards in the hands of consumers. Also, about 75% of card-issuing revenues comes from interest income, which the banks earn by charging, in most cases, 18% to 20% on outstanding card balances.

Bank card rates have remained at these levels for years while market interest rates have been dropping for the last few years, prompting consumer advocates and politicians to clamor for lower credit card rates. And some industry experts say they expect competition to force banks to cut rates.

Nevertheless, the *American Banker* survey found that most banks — 86% of those responding to the survey — have no intention of changing their credit card interest rates during the next year.

The remaining 25% of card-issuing revenues comes primarily from annual fees and "interchange" fees, in roughly equal amounts.

Most banks are charging consumers $15 to $20 a year for standard credit cards and $35 to $45 a year for premium cards.

The interchange fee is paid by the merchant bank to the card-issuing bank for each transaction. The fee, established in the 1960s to compensate card issuers for the cost and risk of issuing cards, now amounts to about 1.5% of the transaction amount.

The largest expense is the cost of funds, followed by operating costs, which vary significantly from bank to bank.

A credit card operation includes high fixed costs. The computers and processing equipment incur similar expenses no matter how many credit card transactions are handled. Therefore, a larger number of transactions means a lower per-transaction cost.

Small banks often use outside data processors, which are considered more efficient than in-house operations for small banks.

The *American Banker* survey found that about 40% of the top credit card banks handle their credit card processing entirely in-house. Another 22% perform this function partially in-house. The balance — about 38% — use an outside operation, according to the survey.

The merchant side of the business provides a relatively small portion of the card operation's revenues — 10% to 12% — but it is an intensely competitive business.

Banks charge merchants a discount fee, which is a percentage of the credit card sale — usually 2% to 4%. Thus, if a merchant pays a 2% discount and deposits a $100 sales slip at the bank, the merchant gets credit for $98.

The services provided to merchants include access to the credit card system for settlement and authorization of credit card transactions. Many banks also provide electronic, card-reading terminals at merchant checkout counters that support the electronic settlement of bank card transactions.

This procedure, known as data capture, eliminates the need for merchants to deposit sales slips at the bank to gain credit for the transaction. Instead, the terminal automatically transmits the necessary information, and the merchant is credited at the end of the day.

79% of Top Banks Offer Data Capture

The *American Banker* survey discovered that 79% of the top banks are providing data capture to merchants.

Bank credit card operations also are confronting the germination of debit card programs. Once used exclusively in automated teller machines, debit cards now are being accepted by merchants for store purchases in dozens of programs around the country.

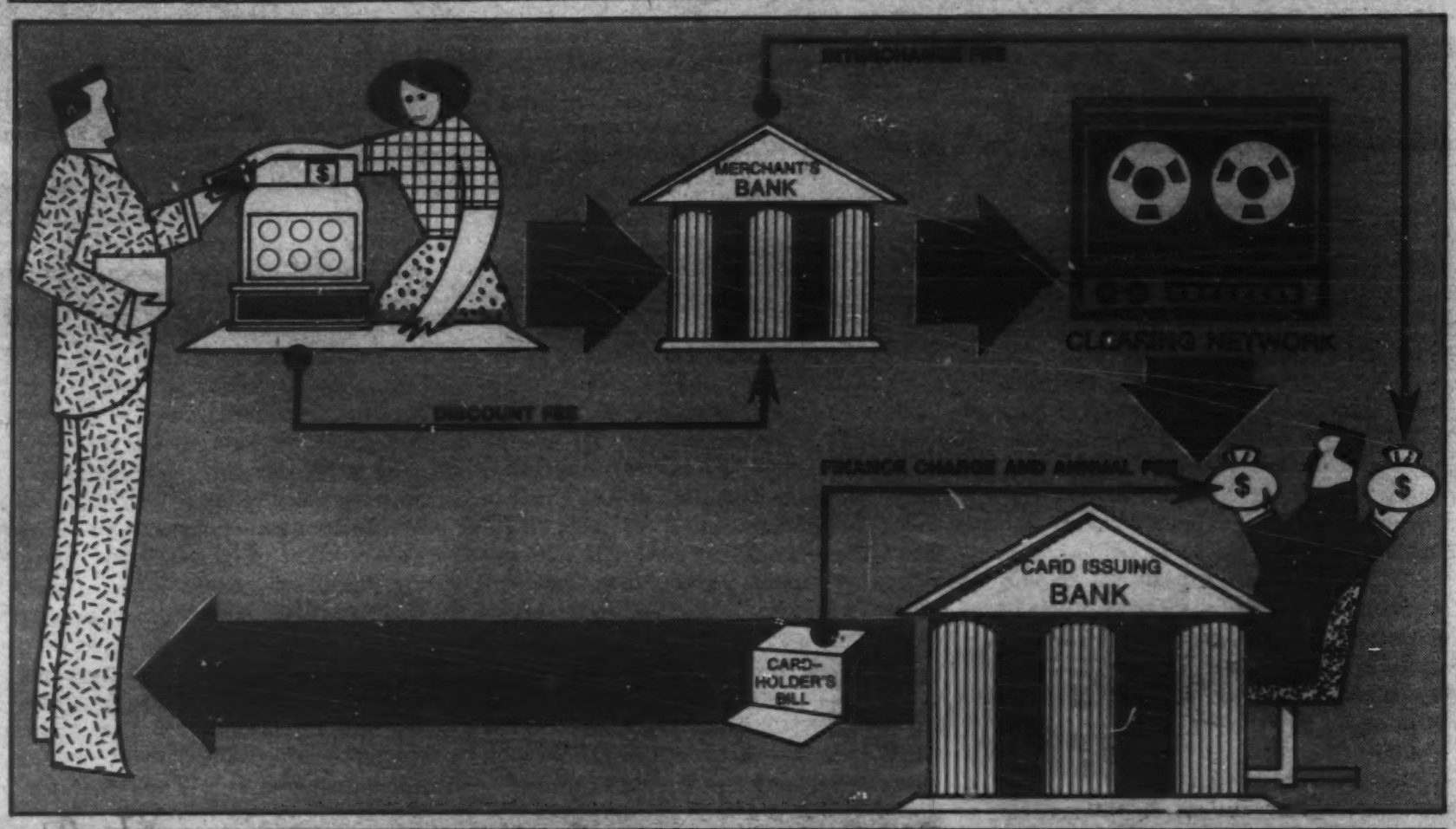
The debit card is similar operationally to the credit card. And 43% of the top banks have consolidated their credit and debit card operations, according to the *American Banker* survey.

Combining the two operations, however, is no simple matter. The debit card is tied to deposits rather than a line of credit, and deposits are a bank's lifeblood, observed Mr. Friedman of Arthur Andersen.

"It's far more widespread in terms of its impact on the bank," he said. "It's a very emotional issue, one that seems to defy rational analysis."

Next: Most banks have no plans to change the interest rate on credit cards, but there is substantial interest in variable-rate cards.

The Path of a Credit Card Transaction



A credit card transaction, shown by the wide arrows, begins in the store. After the customer pays with his credit card, the merchant deposits the sales slip at its bank. The merchant's bank sends the transaction to a clearing network, which routes the data to a card-issuing bank. The card-issuing bank bills the customer. The flow of fees, shown by the narrow arrows, benefits primarily the card-issuing bank. This bank collects an annual fee and interest charges from each cardholder. It also earns an "interchange fee" for each transaction from the merchant's bank. The merchant's bank collects a "discount" fee from its merchants for each transaction.

How banks process credit card accounts...

30	Completely in-house
17	Partially in-house
24	By a for-profit 3rd party
5	By a cooperative

Top Banks Handling Merchant Bank Card Transactions

	Number of Merchants	Number of Merchant Outlets
1. Bank of America, San Francisco	48,800	NA
2. Rocky Mountain Bankcard System Inc., Denver	47,100	NA
3. Citizens Fidelity Bank & Trust Co., Louisville, Ky.	8,300	49,300
4. Marine Midland Bank, Buffalo, N.Y.	31,700	NA
5. Wells Fargo Bank, San Francisco[2]	28,000	37,300
6. Fidelity National Bank, Baton Rouge, La.	22,100	NA
7. Security Pacific National Bank, Los Angeles	18,000	23,200
8. Sovran Bank, Norfolk, Va.	15,900	NA
9. Indiana National Bank, Indianapolis	10,000	20,900
10. First Natl. Bank of Commerce, New Orleans, La.	19,000	20,100
11. Valley National Bank, Phoenix, Ariz.	18,200	19,500
12. First National Bank of Chicago	15,000	NA
13. Michigan National Bank, Lansing	13,100	17,600
14. U.S. National Bank of Oregon, Portland	15,900	17,000
15. First Bank System Inc., Minneapolis	13,100	15,900
16. Mellon Bank, Pittsburgh[3]	12,000	NA
17. Atlantic National Bank, Jacksonville, Fla.	7,300	14,200
18. United Bank of Denver	13,000	13,300
19. First National Bank of Atlanta	6,000	13,300
20. Seattle-First National Bank, Seattle	8,900	13,000
21. Maryland Bank, Newark, Del.	11,400	12,800
22. First City Bancorp. of Texas, Houston	10,000	12,200
23. Southeast Bank, Miami	8,400	12,000
24. Sun Bank, Orlando, Fla.	9,300	11,000
25. Bank of Virginia, Richmond	5,600	10,900

Top Issuers of Premium Bank Cards*

	Total Number of Accounts
1. Maryland Bank, Newark, Del.	401,000
2. Bank of America, San Francisco	400,000
3. Chemical Bank, New York	400,000
4. Great Western Savings, Beverly Hills, Calif.	106,000
5. Bank of Virginia, Richmond	102,000
6. Chase Manhattan Bank (USA), Wilmington, Del.	101,000
7. Wells Fargo Bank, San Francisco[2]	88,000
8. Southeast Bank, Miami	73,000
9. Security Pacific National Bank, Los Angeles	33,500
10. BancOhio National Bank, Columbus	30,000
11. Rocky Mountain Bankcard System Inc., Denver	30,000
12. Indiana National Bank, Indianapolis	26,000
13. Bank of New England, Boston	24,000
14. MBank USA, Wilmington, Del.	20,000
15. Dollar Dry Dock Savings Bank, Bronx, N.Y.	19,000
16. Michigan National Bank, Lansing	18,800
17. Bank of Boston	12,500
18. Citizens and Southern National Bank, Atlanta	12,000
19. Marine Midland Bank, Buffalo, N.Y.	12,000
20. Wachovia Bank & Trust Co., Winston-Salem, N.C.	11,000

American Banker

The Daily Financial Services Nev

150222000015 8/15/05 C11
CONGRESSIONAL INFOR SREV SRI
ACQUIS EDITOR SRI
4520 E. WEST HIGHWAY
BETHESDA MD 20814

VOL. CLI NO. 160 Friday, August 15, 1986 151st Year

TODAY

CITIZENS CLOSED: Citizens National Bank & Trust Co., Oklahoma City, was closed. The Federal Deposit Insurance Corp. was reviewing several offers by other banks and bank holding companies to take over Citizens..... 2

RHODES EXPECTS AGREEMENT: Citicorp executive William Rhodes said he expected agreement within "a few days" on a new short-term loan to Mexico. Mr. Rhodes made the comment after meeting with Mexican President Miguel de la Madrid..... 2

ADVERTISING BILL: A House subcommittee approved legislation that would set standards for advertising deposit accounts and bank credit cards. Some bankers contend parts of the bill are unfair and burdensome..... 2

INTERNATIONAL BRIEFING: The question of whether West Germany and Japan will join the United States in a coordinated cut in interest rates has dominated the Eurodollar bond market for the last week — without providing the market with much steam..... 2

SCHWAB'S FRUSTRATIONS: Charles R. Schwab, who resigned this week as a director of BankAmerica Corp. and its chief subsidiary, Bank of America, had become frustrated at his inability to effect change at the beleaguered banking firm, colleagues said..... 3

COMMENT: A thoughtful assessment of risk and return should precede any headlong rush to embrace merchant banking products or strategies..... 4

VOLUNTARY SURRENDER: A finance company can repossess a car if the debtor brings the car to the dealer for repairs and signs a voluntary surrender form..... 4

SCHUMER'S CREDIT CARD LIST: Rep. Charles E. Schumer, D-N.Y., released a list of banks that have lowered their credit card rates since January. Dozens of banks, he said, have begun lowering their interest rates on credit cards in the face of congressional pressure. "We have seen a crack in the dike of outrageously high interest rates charged by the large majority of American banks," Mr. Schumer said..... 7

Executive Changes..... 5

In the News..... 3

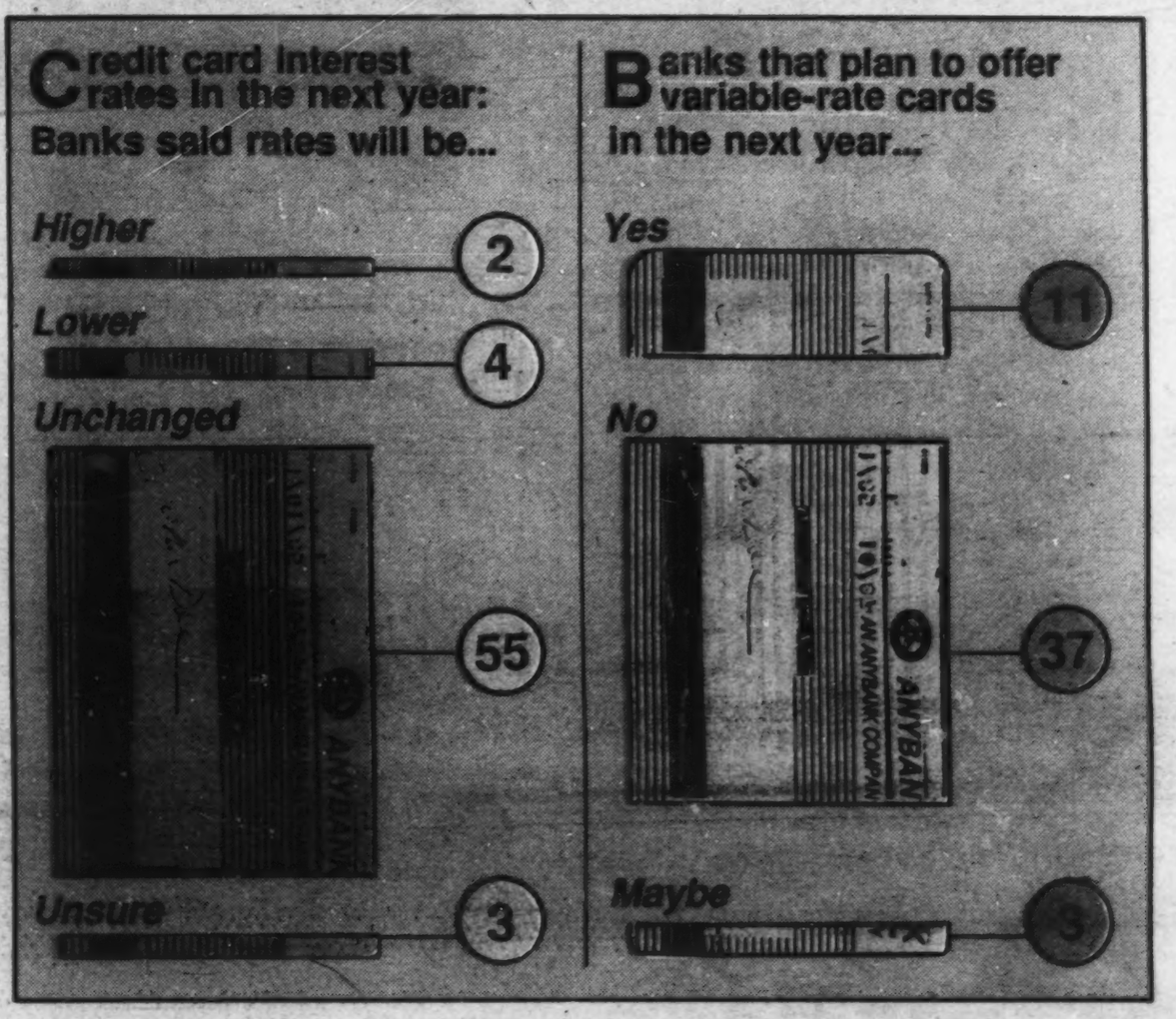
Quote

When you're family owned or closely held, you can snub an offer. But when you have shareholders, and you get an offer worth three times book, it is impossible to show them that they would be better off staying independent.

Kenneth McIlraith president and chief executive officer of the Conifer Group Inc., Worcester, Mass. [Page 7]

Unquote

Most Banks Plan No Cuts in Credit Card Rates



But Some Evince Interest In Variable-Rate Accounts

By MICHAEL WEINSTEIN

NEW YORK — Most of the market leaders in the bank credit card business have no plans during the next year to lower credit card interest rates, but there is considerable interest in variable-rate cards, according to a recent *American Banker* survey of major financial institutions.

Of the top card-issuing banks responding to the survey, 86% said they did not intend to change credit card rates, even though consumer groups and politicians have been pressing for them.

(In Washington Thursday Rep. Charles Schumer, D-N.Y., unveiled a list of banks that have lowered their credit card rates. See page 16.)

Questionnaires were mailed to 130 financial institutions earlier this year, and 77 responses were received by mail or follow-up telephone calls from January through early July.

AN American Banker SPECIAL REPORT

"I think the bankers are resisting the temptation to engage in a gasoline industry-type price war," said Joel P. Friedman, the director of strategic management at the accounting firm of Arthur Andersen & Co., San Francisco.

"That doesn't surprise me," said Stephen Brobeck, the executive director of the Washington-based Consumer Federation of America. "The marketplace has shown little sensitivity to interest-rate variation on credit cards."

While some bankers admitted that consumer sensitivity to credit card interest rates had increased in the last

Card Rates: Page 16 ➡

BIG DEALS: In-State Prices Rise

Premiums Approach Those in Interstate Acquisitions

By BART FRAUST

NEW YORK — The passage of interstate banking laws by several states is slowly erasing the differential between prices paid for in-state bank acquisitions and prices paid for interstate deals.

AN American Banker MONTHLY FEATURE

For the first year following the U.S. Supreme Court's decision upholding regional banking, interstate deals generally were priced at higher multiples to equity and earnings than in-state mergers.

Now, there are indications that in states that have interstate banking laws, in-state deals are becoming just as costly as interstate acquisitions.

"When there are out-of-state alternatives, in-state premiums will rise and there won't be the differential anymore," said Lacy Shockley, a bank stock analyst for Mabon, Nugent & Co., New York.

Ms. Shockley's statement is borne out in July's data for bank merger and acquisition activity.

In-state acquisitions announced last

Big Deals: Page 8 ➡

In touch with Tennessee's future

THIRD NATIONAL CORPORATION
NASHVILLE, TENNESSEE

Biggest Banks Remain Firm on Credit Card Rates Despite Scattered Cuts by Small, Mid-Size Issuers

Continued from Page 1

few months, they also said they thought that banks would be able to keep rates about where they are.

"It's a banker's natural reaction not to lower rates when losses are going up," added Donald J. Auriemma, a consultant based in Garden City, N.Y. Bad-debt losses on credit card loans increased from 1.9% of outstandings in 1984 to 3.3% last year, according to Visa U.S.A. Inc.

"For the most part, credit card rates haven't changed in 15 years," observed Randolph W. Wyckoff, senior vice president at the Bank of Virginia, Richmond. In most cases, credit card rates remain between 18% and 20%.

THE CREDIT CARD BOOM
SECOND IN A SERIES

The insistence on maintaining these rates may put bankers at odds with some Washington politicians, who have proposed federal legislation that would put a limit on credit card interest rates and would mandate additional disclosure of fees and interest rates.

"That's like asking Attila the Hun if he's going to stop beating people over the head," remarked Curtis Prins, the staff director of the House Banking Committee's consumer affairs and coinage subcommittee, when told of the survey results.

There has been scattered price cutting in the last year or so. A number of small and medium-size issuers have lowered the interest rates on credit cards, and some of them have made significant cuts.

"I think we're seeing some irrational price cutting," said Mr. Friedman, referring to banks that have reduced credit card rates to 14% or 15%. "They'll cut their margins so thin — then if any economic conditions become unfavorable, they'll be in a loss position."

Top Banks Resist Rate Cuts

However, the top dozen or so banks, which set the pace for the industry, generally have resisted rate cuts.

The lone exception, Manufacturers Hanover Trust Co., lowered its rate last October from 19.8% to 17.8%. Since then, the bank says, it has attracted nearly a million new accounts.

"The industry is led by the top dozen, and the top dozen have decided not to take the hit to the bottom line," Mr. Auriemma said.

Other big credit card banks have taken a different tack.

The Marine Midland Bank recently announced a variable-rate card with a lower rate than its fixed-rate card but a higher annual fee. Marine Midland will keep issuing its 19.8% fixed-rate card.

Banks levy these credit card fees on consumers...

45	Delinquency fee
27	Lost card fee
11	Returned payment check fee
10	Overlimit fee
9	Cash advance fee
3	Statement copy fee
1	Extra card fee

The Security Pacific National Bank, Los Angeles, said last month that it would offer lower interest rates depending on how many Security Pacific services are used by the cardholder. Rates are tiered from 16% to 20.4%.

And Wells Fargo Bank in San Francisco is lowering its credit card rate from 20% to 17% for customers who have held the bank's cards for at least five years and whose monthly purchases amount to at least $100.

"Things have changed since February," conceded one banker, who requested anonymity. "I agree there is a much greater sensitivity to interest rates on the part of the consumer than eight months ago."

Another banker said that rate-sensitive consumers are more aware than ever of card rates. However, he added, these customers are "still a small number."

According to the *American Banker* survey, 55 out of 64 financial institutions said they did not intend to change card rates. The four institutions that are planning to lower their rates are considering introducing a variable-rate credit card. The interest rate of a variable-rate card is related to, and moves in tandem with, a preselected market interest rate.

In fact, there is considerable interest in variable-rate cards. About one-quarter of the banks that do not now offer a variable-rate card are planning to offer or are considering offering one in the next year, according to the survey.

The Buffalo-based Manufacturers and Traders Trust Co., which now has a fixed-rate card at 19.8%, is introducing a variable-rate card in order to provide its customers with a more equitable rate and to protect itself against any future increases in interest rates, said Patricia M. Knab, a vice president with Manufacturers and Traders.

"If the prime hits 20% again, we're in negative numbers," she said, referring to high interest rates of the early 1980s when credit cards were money losers for banks.

Manufactures and Traders also is offering customers the option of a new fixed-rate card at 18%.

A southern bank is introducing a variable-rate premium card because it can offer a card with a lower-than-usual rate while retaining the flexibility to raise the finance charge if interest rates increase, according to an executive at the bank. The bank's standard card carries an 18% rate.

Variable Rates Catching On

"I think a bank's crazy not to at least be looking at it," she added. "More and more customers are getting accustomed to variable rates [in general]."

Mr. Auriemma, the consultant, said he expected that most variable-rate plans are for premium cards, which are generally more expensive and offer extra services and higher credit lines compared with standard cards. "It's a fairly intelligent positioning," he said, observing that the typical premium cardholder is more savvy about interest rates than ever before.

Banks that offer variable-rate cards...

Yes 19 No 55

"We may be forced into it either by legislation at the state or the federal level," said an executive at a mid-Atlantic bank that is considering a variable-rate card. "If we're not forced into it, we'd rather stay where we are." The bank now charges 18% annually on purchases made with its standard bank cards.

The survey also found that many banks impose a range of other fees on credit card customers. The most common fees are delinquency fees, assessed when the cardholder pays the bill late; over-limit fees, charged when cardholders exceed their credit limits; and fees, levied when the customer's check for payment of the credit card bill is returned.

Another part of the cardholder pricing mechanism is the grace period. Usually about a month long, it is the time during which purchases are charged to a customer's account but no interest accrues. Almost every bank responding to the survey offers some sort of grace period to its cardholders who pay off their outstanding balances by the end of the billing cycle.

Industry experts say about one-third of bank credit card customers pay their bills before the grace period ends. Thus, they avoid paying any interest to the bank and enjoy what amounts to an interest-free loan from the bank. These so-called convenience users bring down the actual yield of a portfolio below the interest rate that is charged on credit card loans.

However, only one bank out of 56 is even considering eliminating the grace period, according to the *American Banker* survey.

"There are very few banks in the country who have done that," commented Mr. Friedman of Arthur Andersen. Such a move, he added, would compel convenience users to abandon a bank's credit card.

Although convenience users are not as profitable as consumers who carry outstanding balances from month to month, they represent additional accounts that are being handled by the bank's processing operation. These fixed, back-office costs are lower on a per-account basis if they can be applied to a larger number of accounts.

"There's a great reluctance to drive away accounts," Mr. Friedman said.

Next: A ranking of the top banks handling merchant bank card transactions.

Dear Reader, How Are We Doing?

The American Banker wants very much to make sure its coverage of the financial services industry meets your information needs. So would you spend a moment to give us some feedback on the American Banker Special Report **The Credit Card Boom**? Over the past year we have incorporated many of your suggestions to provide more meaniingful information. Please return this questionnaire to William Zimmerman, Editor, American Banker, One State Street Plaza, New York, N.Y. 10004. Telephone (212) 943-5712.

(1) How useful was the information in this series?

(A) Very Useful ☐ (B) Useful ☐ (C) Not Useful ☐

(2) What do you like **best** about this series?

(3) What do you like **least** about this series?

(4) What other subjects would you like to see American Banker cover in an in-depth series of articles?

Name (optional)

Title

Company

Address

Phone

Thank you for helping us improve.

Going places. Look for

EXECUTIVE CHANGES

a daily feature in

American Banker